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Present Status of Our Usury Law

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NOTES

PRESENT STATUS OF OUR USURY LAW

The word usury is very familiar to all students of history and law as it has been a part of both the spoken and written languages of almost every nationality of people from biblical time to the present day.

Many of the members of the Kentucky Bar and the Court of Appeals of Kentucky have been in close touch with the question recently as important cases have been brought to their attention from almost every section of the Commonwealth. Probably one of the chief reasons for this is that Kentucky is a debtor state and at different intervals since 1924 there has developed an urgent need of credit in order that homes might be built to provide for rapid increase of population in a community.

Almost all finance companies have been subjected to more or less criticism on the score of the rates charged for their service. Since brokers who procure loans for borrowers having improved real estate to offer as security have been forced to resort to the Court of Appeals, in order to decide the resistance they have met in the collection of claims by counter-charges of usury, in more cases than any other, this article will be confined to that branch of the subject.

Section 2218, Carroll's Kentucky Statutes, prescribes that legal interest shall be at the rate of six dollars upon each one hundred dollars for one year, and at the same rate for a greater or less sum and for a shorter or longer time. The only qualification or modification of this rule is that a banking institution is allowed to make a minimum charge of one dollar ($1) for any loan negotiated at said institution.

In the case of *Henderson Building and Loan Association* v. *Johnson*,[1] the Court holds that a building association might exact reasonable dues in addition to legal interest. The Court has not waivered from the general rule laid down in that case.[2]

[1] 88 Ky. 191.

[2] *Union Central Life Insurance Company* v. *Edwards*, 219 Ky. 748; 294 S. W. 502; *Webb* v. *Southern Trust Company*, 11 S. W. (2nd) 988; and *Ashland National Bank, Trustee of an Express Trust* v. *A. S. Conley et al.*, 231 Ky. 844.

All of the cases cited *supra* hold that the agent of the borrower may exact a reasonable charge for services rendered in addition to legal interest. What the Court may construe to be reasonable or unreasonable charges in excess of the legal rate of interest, in the absence of any standard to be found in the adjudicated cases, is very different to predict, but it is safe to say that the Court will look through the form to the substance.

FORM OF THE TRANSACTION NOT MATERIAL

Whether a transaction involving a loan of money is or is not affected by the taint of usury, is a question of fact to be decided by the court or jury, after taking all of the evidence into consideration in connection with the statutory definition of usury. If the decisions of the Kentucky Court of Appeals are read carefully the reader will form the conclusion and will be firmly convinced that the substance, and not the form, of the transaction is alone considered. If, in its substance, the transaction is of the character denounced by law, the penalties of usury cannot be escaped by the fact that the transaction wears a cloak or is put in an innocent form and that, judged by the form alone, the usury could not be upheld. All of our state and federal Courts, and the Kentucky Court of Appeals in particular, are very strict in holding that the consequences of violating the usury statute are not avoided, no matter what clever device may have been employed to conceal the true character of the dealings involved.

It is very difficult in cases where the evidence reveals the whole transaction, to draw a correct and logical conclusion as to what constitutes and what does not constitute usury without first ascertaining the tests applied by the court when they decide the matter. A strict test is that something has been exacted for the use of money in excess of the rate allowed by statute. If the line of Kentucky decisions are followed we find that when they apply a strict interpretation by disregarding form and inquire whether the real substance of the plan is a loan of money for more than 6 per cent interest per annum, and if the Court so finds, then no device of form can relieve the taint of usury.

USURY AS AFFECTED BY SERVICE CHARGE

Almost all of the companies organized and operated in Ken-

tucky for the express purpose of procuring loans for borrowers derive their profits from monies received from borrowers as service charges. There are about as many different plans devised to collect such service charges as there are companies. The plan of the Southern Securities Corporation, one of the appellants in the case of *Ashland National Bank, Trustee et al.* v. *A. S. Conley et al.*[3] is first to have the persons desiring to borrow money sign an application form of contract designating Southern Securities Company agent to procure a loan for them; then have a deed of trust prepared to the Ashland National Bank, Trustee of an Express Trust, setting up the principal amount of the loan in a definite number of principal bonds which are secured by a first and superior lien upon the real estate of the borrower. All of said bonds are made payable to bearer and bear interest at rate of 6 per cent per annum. This deed of trust also provides for a definite number of subordinate notes payable to bearer, secured by mortgage upon said premises, subordinate, however, to the bonds and the interest coupons hereinbefore referred to. These subordinate notes do not bear interest until after maturity, and are executed for the expenses and fees connected with the loan. In order to provide a fund with which to retire the bonds with interest coupons attached, and the notes hereinbefore referred to, the borrower agrees to pay a certain specified sum each month for 120 months.

The question as to what exact amount the courts will permit to be exacted from a borrower for expenses is very problematical. Some brokers charge a flat rate of 5 per cent to 6 per cent of the amount procured for the borrower and deduct same from the principal, while others follow a plan similar to that adopted by Southern Securities Corporation, which from available figures in the case cited supra runs to about 6.9 per cent. It is well settled that the court must be satisfied that the agreement to compensate for services is not an attempt to conceal a usurious transaction. The best way to avoid confusion on this subject is to make the borrower understand at the time he makes his application that the company is not loaning its own money and that funds to take care of the amount he wishes to secure can be had

[3] Cited *supra* note 2.

only after labor and expenses have been incurred. The borrower must then agree to reimburse these expenses.

The general attitude of the Kentucky Court of Appeals upon the usury question is that of bias against all forms of contract involving interest charges in excess of 6 per cent and to search for the possible intent to evade the usury statute by the form of the contract.

All of the recent opinions of the Kentucky Court of Appeals seem to be favorable to the contentions of the companies acting as brokers. This fact might lead us to believe that the Court is becoming more lax in enforcing the usury statute, but if we examine the facts in any of these recent decisions more closely we will find that the Court is just as strict in looking for a scheme to avoid the usury statute as they ever were, and they have decided the cases as they have, only after being firmly convinced that the company procuring the loan did so as the agent of the borrower. It is also very apparent from this line of decisions that the Court is probably not especially concerned with the amount charged for services if they are convinced that the company making the charge is the borrower's agent. The "loan shark" cannot possibly be more secure in his dealings than he has been previous to these recent decisions.

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